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ANY AND ALL SIMILAR APPLICABLE STATE AND LOCAL PROVISIONS**

Memorandum

To: David Carrington, President, Jefferson County Commission

From: John S. Young, LLC, Receiver, Jefferson County Environmental Services Department

Date: August 11, 2011

Thank you for forwarding the County's settlement proposal dated August 7, 2011.

In my capacity as the chief executive officer of the Receiver of the Jefferson County Environmental Services Department, I was requested by Judge Johnson, the County, various warrant holders, and the Governor of Alabama to assist in facilitating a negotiated settlement regarding the sewer debt between and among the County, warrant holders and the State. As indicated from the beginning to all involved parties, the Receiver's involvement in these negotiations has been to attempt to assist the parties in reaching a consensual resolution to the debt crisis. The Receiver has not and is not serving as an authorized representative or agent of any warrant holders, the County or the State in this process.

Since receipt of the County's August 7 proposal, I have engaged in intensive discussions with as many stakeholders as possible. I believe that the following terms demonstrate that the parties should now be able to move towards formalizing resolution of the sewer debt crisis. In fact, each of the projected rate increases set forth below are less than those resulting from the County's August 7 proposal.

One of the conditions imposed by the County in its August 7 proposal was a term sheet signed by all creditors. This requirement was not feasible given the very short timeframe allowed by the County and the number of entities involved (over twenty separate companies, banks, insurance companies – and various regulators). That being said, I believe that the terms set forth below, which has been drafted based on extensive conversations with representatives of existing warrant holders, the County, the State of Alabama, and New York insurance regulators (and have reviewed with warrant holders) should form the basis of a global solution to the sewer debt crisis.

The terms contained herein are entirely contingent upon the negotiation and execution by all parties of a comprehensive settlement agreement (the "Settlement Agreement"), legislation and a successful refinancing to implement the terms of the settlement. None of the terms contained herein are binding on any warrant holders, the County, or the State until execution of such an agreement by all participating parties.

The provisions contained herein represent the best opportunity for all involved parties to resolve the sewer crisis that began more than three and a half years ago. This proposal represents a total of approximately \$1.9 billion in concessions when the SEC settlement, swaps and default interest

are taken into account. That amount includes over \$1 billion in concessions on the County's current principal obligations under the sewer warrants. The main points of this proposal include:

- **County proposed rate increases lowered.** This proposal achieves lower annual rate increases than those resulting from the County's proposal. Potential scenarios for these rate increases¹ are as follows:

	Years 1-3	Years 4-40
Base Case – creditor concessions ²	7.8%	3.0%
Base Case with \$1 billion warrant insurance	7.1%	3.0%
Base Case with 25 basis point reduction ³	6.6%	3.0%
Base Case with 25 basis point reduction with \$1 billion warrant insurance	6.1%	3.0%

As many of the Commissioners and other parties have repeatedly stated, the most important aspect of resolving the sewer system's debt crisis should be the future rates that would be imposed on the system's customers. This proposal meets and improves upon the County's proposal in regard to projected sewer rates. The State and County's financial advisers have been engaged in and provided the data supporting these projections. These projections are consistent with current trends in interest rates.

- **Includes valuable state participation.** As the County is aware, these proposed rates have been made possible by the State's willingness to support a refinancing with a moral obligation. The present value of the moral obligation in terms of savings to the County on future debt service costs is estimated to be worth more than \$1 billion.
- **Ensures the long-term financial and economic viability of the sewer system.** Based on the system's current capital plan, the proposed refinancing contemplated herein would allow the system to take care of its long-term capital needs for forty years. In contrast, if no settlement is reached, in a bankruptcy scenario the System may not have access to

¹ The financial models supporting these projections are attached.

² Includes assumed \$20 million in concessions from unidentified warrant holders and other sources. The Receiver will make best efforts to secure these concessions by September 16, 2011.

³ Assumes potential reductions in anticipated interest costs in refinancing from Base Case and that County is given benefit of all such savings.

additional financing for capital improvements and may be forced to look to the County and potentially the State for capital funds to meet its obligations under the EPA Consent Decree.

The following provisions are necessary components of any ultimate framework for settlement.

1. **Refinancing.** Under the Base Case scenario referenced above, the warrant holders and County will pursue a refinancing transaction (the "Refinancing") with the following principal terms:
 - (a) Aggregate principal amount: \$2.326 billion.
 - (b) Proceeds to be applied as follows:
 - i. \$233,000,000 to Debt Service Reserve ("DSR").
 - ii. \$23,300,000 to pay costs of issuance.
 - iii. \$2.07 billion to redeem all outstanding sewer warrants based upon negotiated concessions and other terms of settlement agreement.
 - (c) 1.25x debt service coverage.
 - (d) 40-year final maturity.
 - (e) Primary security/source of payments: priority pledge of gross sewer revenues.
 - (f) Additional security: moral obligation covenant by State of Alabama to seek legislative appropriations to replenish draws, if any, on the DSR.
 - (g) Operating expenses covered by cash flow and capital needs covered by current warrant reserves (at both Regions and BNY) and cash flow.
 - (h) Closing: No later than June 30, 2012.
 - (i) All terms of Refinancing are subject to any changes that may be required by rating agencies, underwriters, and bond holders if bonds are privately placed (reasonably acceptable to all participating parties to settlement and Refinancing) for the refinanced debt.
2. **Creation of independent public corporation for ownership, management and financing the sewer system.** The County will seek, and the Governor will support, legislation in a special session to authorize creation of a new form of governmental utility service corporation (GUSC) to serve as the issuer of the Refinancing and the owner/operator of the sewer system (the GUSC must be a municipality for Bankruptcy Code purposes and the refinanced bonds must be special revenue bonds as defined by 11 U.S.C. § 902(2)). County to immediately send the Receiver a copy of current drafts of governance documents and legislation for formation of a GUSC and to authorize County

counsel to work with Receiver's and Creditors' counsel on such documents and legislation. The proposed GUSC legislation must be reasonably acceptable to all participating parties. Significant features of the GUSC legislation will include:

- (a) Majority of directors to be appointed by Governor in consultation with County; remainder to be appointed by County (at all times the acting majority of directors will consist of directors appointed by the Governor). All directors to possess appropriate professional credentials as specified in enabling legislation. County to appoint directors after refinancing bonds are paid or refinanced without credit support from State.
 - (b) Legislative provisions for establishing sewer rates and charges sufficient to support the System and Refinancing debt.
 - (c) Authorization to file Chapter 9, but only with consent of the Governor.
 - (d) Governance provisions to ensure independent, efficient and effective operation of the System.
 - (e) System to be conveyed to GUSC at close of Refinancing.
 - (f) Receiver to stay in control of System until the closing of the Refinancing and the GUSC takes over the System; Receiver to provide transitional oversight for a duration to be determined after the GUSC takes over the System. The County shall cooperate in all respects in the transition of the System to the GUSC.
3. **Low-income assistance program.** The County and/or warrant holders will fund \$20 million to establish and support the low-income assistance program proposed by the Receiver.
4. **Definitive Settlement Agreement.** The County, the Receiver, the State of Alabama and representatives of participating warrant holders will enter into a definitive Settlement Agreement to implement the terms contained herein. The Settlement Agreement will also specify the conditions to the sale and issuance of the Refinancing debt by no later than June 30, 2012. If the conditions to the issuance of the Refinancing debt are not satisfied or waived, the rights and positions of all parties will be fully preserved and no party shall use the fact of another party's entry into the Settlement Agreement in any subsequent or continued litigation. Settlement Agreement is to be finalized and executed by September 16, 2011. Conditions to issuance of the Refinancing debt shall include, without limitation:
- (a) Adoption of legislation regarding:
 - i. GUSC formation and authorization.
 - ii. State moral obligation pledge.

- iii. Mandatory sewer hookups for new construction within specified distance of existing sewer lines and for failed septic tanks, subject to environmental limitations (legislative action only if necessary).
 - iv. Solution to the County's general fund issue.
 - v. Conditional local revenue source for reimbursement of State appropriations, if any.
- (b) Pursuant to appropriate documentation, dismissal with prejudice of all litigation and release of all claims involving and among the County and participating warrant holders related to the System, including but not limited to any litigation involving the County, the Monoline Insurers, and JPMorgan (collectively, the "Litigation"), and a stay of the Litigation (other than the Receiver action), including discovery, pending a Refinancing.
 - (c) Dismissal of the *Wilson* litigation with prejudice.
 - (d) The County complies with the Receiver Order through the date of a Refinancing.
 - (e) Negotiation of closing agreement with the IRS covering existing sewer warrants and proposed refinancing bonds, on terms satisfactory to the County and with no taxes, costs, or other liabilities to existing warrant holders.
 - (f) Judicial confirmation of the financing structure and proposed sewer rate model.
 - (g) County may retain independent consultants (the "County Consultants") to review Receiver's cost of service, capital and operating cost studies by October 31, 2011. Receiver to pay the reasonable cost thereof (within the limits of a budget pre-approved by the Receiver) from sewer revenues.
 - (h) Total annual debt service costs of the Refinancing will not exceed a predetermined debt schedule determined no later than pricing of Refinancing based on market conditions and the County's preferences.
 - (i) Delivery of County's audited financial statements through fiscal year 2010 by October 31, 2011 and its fiscal year 2011 audited financial statements by January 31, 2012.
 - (j) Consent of or no objection by the New York Department of Insurance (or other necessary regulatory authorities) to concessions provided by the monoline insurers and any other aspects of Refinancing transaction.
 - (k) All remaining sewer-related interest rate swaps to be terminated with no liability to the County, subject to obtaining formal termination from all swap counterparties.
 - (l) The Receiver will pay within 30 days of execution of the Settlement Agreement

the following amounts in satisfaction of all outstanding overhead charges of the County for services to the Environmental Services Department:

- i. \$5.3 million for FY 2010;
 - ii. \$3.0 million for FY 2011; and
 - iii. \$100,000 per month in FY 2012 until close of the Refinancing.
- (m) The County will not file for Chapter 9 protection without the Governor's consent during the period between now and the close of a refinancing.
 - (n) The monolines must be satisfied (based on verifiable financial information) that there will be no further draws on their surety policies prior to Refinancing.
 - (o) No acceleration of sewer debt pending the Refinancing.

5. Role of the Receiver.

- (a) All provisions of the Receiver Order will remain in full force and effect until closing of the Refinancing and entry of an order in the Receivership action dissolving the Receivership.
- (b) Receiver will continue to administer and control the sewer system from the date of the Settlement Agreement through the closing of the Refinancing pursuant to terms of the Receiver Order.
- (c) The Receiver will maintain, but not enforce, its claim to the \$75 million JPMorgan settlement monies until the close of the Refinancing; during this period, the County will agree to waive, or to a tolling agreement regarding, any statute of limitations applicable to this claim.
- (d) Receiver will, with cooperation of the County, implement interim rate increases consistent with terms of settlement and Refinancing, including on or about October 1, 2011, and on or about the date of Refinancing.
- (e) Upon issuance of the refinancing bonds, the Bank of New York receivership litigation against the County will be dismissed, and the appointment of the Receiver will terminate upon entry of an order in the Receivership action dissolving the Receivership. John Young will provide transitional assistance to the GUSC after the date of issuance of the refinancing bonds.
- (f) Any terms applicable to the Receiver not contained in the Receiver Order are terminated in the event the Settlement Agreement is terminated.

6. Series 2001-B General Obligation Warrants (GO Warrants). JPMorgan will (a) waive approximately \$9 million in claims arising from termination of a *pari passu* swap and accrued and unpaid default interest on such GO Warrants and (b) reinstate the original

amortization schedule applicable to the GO Warrants.